

General Information Letter: Provision of leased employees who will solicit sales of tangible personal property on behalf of the lessee is not protected by Public Law 86-272.

November 24, 1998

Dear:

This is in response to your letter dated November 11, 1998, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c).

In your letter you have stated the following:

We are writing to you on behalf of our client (the "Company") and its sole shareholder, in an anonymous fashion, in response to your letter ruling. The Illinois Department Of Revenue issued a ruling earlier this year in which you found the existence of nexus for income tax purposes. We respectfully request that you reconsider your position based upon the new positions and authority discussed hereafter.

#### Facts

We have reiterated the facts verbatim from the previous ruling request. The Company is an S Corporation for federal income tax purposes as defined by the Internal Revenue Code §1361. The Company is incorporated in New Jersey and its sole office location is within New Jersey. It does not have any corporate locations within Illinois. In addition, the Company has individual shareholders who are not residents of Illinois and do not conduct any business activities within Illinois.

The Company provides its customers with leased employees who are considered detailmen. Generally, detailmen visit doctor's offices and other medical facilities to promote a pharmaceutical product. Such promotion consists of encouraging sales, explaining product usage and other product information, providing samples owned by the Company's customer, and answering questions relating to the products. The ultimate purpose of the visits is to recommend purchases of these products. The company's employees do not call on customers within the state to collect on delinquent accounts. They do not accept returned merchandise or make adjustments on that merchandise. In addition, they do not pick up damaged or out-of-date merchandise or make adjustments for those products. The employees do not authorize credit for existing or potential customers, nor do they investigate complaints by customers within Illinois. The employees do not receive purchase orders or make "spot sales" of samples that they carry with them. They do not accept or secure deposits of down payments, nor do they collect installment payments for purchased merchandise. The employees do not repossess products or perform any inspection of products. The employees do not set up merchandising or advertising displays, nor do they arrange cooperative advertising agreements with their customers. They do not conduct training courses or schools for

their customers, agents, or distributors. In addition, they do not hold meetings, handle complaints, troubleshoot or give advice to potential customers. Lastly, no deliveries are made into Illinois by the Company since the Company is detailing products for its customers. It is the Company's customers that handle deliveries and all related activities. The Company has no presence in Illinois except for the activities of the detailmen.

It is our contention that Federal Public Law 86-272 (15 U.S.C. §381) is applicable to the Company and/or nonresident shareholders despite the fact that the Company's detailmen's efforts solicit products for other unaffiliated businesses. As a result, the detailmen activities of the Company within Illinois are not nexus-bearing activities for income tax purposes.

#### Discussion

Federal Public Law 86-272 (15 U.S.C. §381) states that:

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

We had provided you in our previous ruling request with sufficient support to conclude that detailmen activities do not exceed "solicitation." See *Wisconsin Department of Revenue v. William Wrigley Jr., Co.*, 112 S. Ct. 2447 (1992); *Smith, Kline and French Laboratories v. State Tax Commissioner*, 403 P. 2d 375 (Or. 1965); *Muro Pharmaceutical, Inc. v. Allan A. Crystal, Commissioner*, 1994 WL 395266 (Conn. Super. 1994). Therefore, we are addressing in this letter the applicability of PL 86-272 to companies which perform a service of merely soliciting orders on behalf of its customers.

Although a perception may exist that PL 86-272 does not apply to service providers, we strongly believe that an exception exists for service providers selling tangible personal property. PL 86-272 provides an exemption from state income taxes for a "person," based on the type of activities performed within a state. Such activities must be limited to solicitation of orders by such "person." There is absolutely no requirement that the "person" must sell its own tangible personal property. The relevant sections of PL 86-272 provide that a

state cannot impose an income tax if "... the only business activities within such state by or on behalf of such a person...are...the solicitation of orders by such a person...for sales of tangible personal property..." The term "by or on behalf of such person" refers only to the business activities and not which company owns the tangible personal property. Therefore, PL 86-272 only requires the review of a person's own business activities for selling tangible personal property which theoretically could belong to any other business. To conclude otherwise would be reading into PL 86-272 an interpretation which is not apparent. As a result, the service of providing leased employees who solicit tangible personal property should be a protected activity.

The State of New York has espoused this theory concerning the taxation of activities within its state. The New York Department of Taxation and Finance (the Department) released an Advisory Opinion, TSB-A-91(2)C, which stated that the leasing of employees who conduct activities in New York will subject the out-of-state company to taxation, only if the underlying activities exceed solicitation as outlined in PL 86-272.

The taxpayer in this decision leased employees to its customers. These employees conducted administrative functions for the company's clients. Despite the fact that the taxpayer was providing a service to its customers, the Department held that PL 86-272 should be considered and that it looks to the underlying activities of the leased employees to determine whether the lessor is "doing business" in New York. The activities (administrative functions) that the leased employees were providing were held to violate PL 86-272 and were therefore subject to income tax. The relevance of this decision is that PL 86-272 was the appropriate authority to consider, despite the performance of a service or the leasing of employees. The Department looked to whether the administrative activities exceeded solicitation activities rather than determining that leased employees are providing a service in general. In the Advisory Opinion, the activities did exceed solicitation activities. The Department emphasized that the activity itself must be analyzed. In the Company's case, the detailmen activities are not exceeding solicitation. The intention of PL 86-272 is to avoid burdensome taxation of parties whose only activity within their state is solicitation, regardless of whether the solicitation is being conducted on their own behalf or on behalf of others. This intention has been clearly manifested in TSB-A-91(2)C.

Although we have not found relevant authority in this area in Illinois, we believe guidance can be drawn from the aforementioned decision and the literal language of PL 86-272. In applying PL 86-272 and this decision to the Company's situation, it is clear that the Company's detailmen activities within Illinois should not cause nexus for income tax purposes.

### **Response**

In the absence of any significant supporting authority for your position, a broad contextual reading of the Congressional enactment is helpful. "The essential purpose and design of Public Law 86-272 were to grant tax immunity to out-of-state vendors who are not 'local merchants,' but have salesmen in the State who

solicit orders for acceptance out-of-state and for shipment of the goods to the customers from other States." (Hellerstein and Hellerstein, *State Taxation*, 2d Ed., 6.13(1)(c)). PL 86-272 was passed to protect a type of interstate commerce, the interstate sale of tangible personal products. This contrasts with your formulaic interpretation, which emphasizes the "activity" of solicitation. Illinois will not change the already stated position that a service company cannot be protected by that federal statute.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Sincerely,

Kent R. Steinkamp  
Staff Attorney -- Income Tax

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KS:ks